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IN THE

Supreme Court of the United States

No. ~~933~~ 44-47

JOHN V. DOBSON,
Petitioner,
vs.
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

~~JOHN V. DOBSON,~~
~~Petitioner,~~
~~vs.~~
~~GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,~~
~~Respondent.~~

E. W. DOBSON,
Petitioner,
vs.
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR,
Petitioner,
vs.
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

H. J. HARWICK,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

To the Honorable Harlan F. Stone, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

John V. Dobson, E. W. Dobson, First National Bank and Trust Company of Minneapolis, as Executor of the estate of James N. Collins, deceased, and H. J. Harwick, respectively pray for writs of certiorari to review the judgments of the Circuit Court of Appeals of the Eighth Circuit entered on March 2, 1943 (C. C. A., R. 15-17), respectively affirming the decision of the United States Board of Tax Appeals in the case of *H. J. Harwick vs. Commissioner of Internal Revenue*, No. 12421 (Harwick, R. 10), reversing the decision of the Board in the case of *Guy T. Helvering, Commissioner of Internal Revenue, vs. E. W. Dobson*, No. 12420 (R. 40), and in the case of *Guy T. Helvering, Commissioner of Internal Revenue, vs. Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis, Executor*, No. 12429 (R. 15), and remanding said cases with instructions to tax as ordinary income the entire recoveries attributable to the purchase price of stock which had been sold in prior years at losses which had been claimed and allowed, and reversing the decision of the Board in the case of *John V. Dobson vs. Guy T. Helvering, Commissioner of Internal Revenue*, No. 12426, and in the case of *Guy T. Helvering, Commissioner of Internal Revenue, vs. John V. Dobson*, No. 12425 (R. 62), and remanding said cases with instructions to tax as ordinary income the entire amount recovered in 1939 attributable to the purchase price of stock

which had been sold in 1930 and the loss thereon claimed and allowed in said year.[1]

STATEMENT OF THE MATTERS INVOLVED

These cases involve the legality under the Internal Revenue Code and the United States Constitution of treating as taxable income amounts recovered on an investment (through refund of part of the purchase price) under circumstances which establish conclusively that the taxpayer had not realized and would not realize any *gain* from such investment. The investment here involved consisted of corporate stock which had been sold at a loss by the purchasers prior to the year of recovery.[2] Subsequently an action for rescission of the original purchase price was settled by a return of a part only of the original purchase price. The amount of the recovery was less than the loss sustained upon the sale by the purchasers and said loss, although referred to in the taxpayers' income tax return for the year in which the sale occurred, did not offset any taxable income for the reason that said return already showed a net loss without using this particular deduction.[2]

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[1]Because all of the above cases were consolidated before the Circuit Court of Appeals for the Eighth Circuit for the purpose of the preparation of the record and briefs and for the purpose of argument and decision, a single petition for writs of certiorari is filed. The consolidated record with respect to these cases contains four parts, viz.: (1) the principal record which includes all of the records in these cases before the Circuit Court of Appeals except (2) the record in the H. J. Harwick case, No. 12421, (3) the partial record in the John V. Dobson case, No. 12426, containing the petition of John V. Dobson for review of the decision of the United States Board of Tax Appeals, notice of filing, and acknowledgment of service of the same and certificate of the clerk to the transcript, and (4) additional proceedings in the Circuit Court of Appeals. Reference herein to the principal record is in the form of (R. 5), reference to the record in the H. J. Harwick case is in the form of (Harwick, R. 5), reference to the partial record in the John V. Dobson case is in the form of (Dobson, R. 5), and reference to the additional proceedings in the Circuit Court of Appeals is in the form of (C. C. A., R. 5).

[2]Slight variations in these facts exist in the J. V. Dobson and Harwick cases. The Circuit Court of Appeals for the Eighth Circuit in view of its decision in the other cases did not find it necessary to pass on the materiality of these variations.

PROVISIONS OF THE CONSTITUTION OF THE UNITED STATES AND STATUTES INVOLVED

Amendments to the Constitution of the United States, Article XVI:

> "The Congress shall have power to lay and collect taxes on income from whatever source derived without apportionment among the several states and without regard to any census or enumeration."

Sec. 22 (a), *Internal Revenue Code*, 53 Stat. 9; 574; 575:

> "(a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a state, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income."

STATEMENT OF FACTS

The stipulated facts (R. 21-25, 44-47, 74-79, Harwick, R. 20-30) in each of the above cases, which have been consolidated for briefing, argument, and decision in the Circuit Court of Appeals and for the preparation of this petition, were adopted by the United States Board of Tax Appeals as its Findings of Fact (R. 15-17, 40-42, 63-64, Harwick, R. 10-13). Because neither party has distinguished between the facts involved in any of these cases in so far as the *general principle* involved in this petition is concerned and in the interests of clarity and brevity we will hereinafter set forth only the facts involved in *Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis, Executor, vs. Guy T. Helvering, Commissioner of Internal Revenue.*

Several years before the taxable year 1939 the four taxpayers here, all residents of Minnesota, had made individual purchases in that State from National City Company of the stock of National City Bank of New York, and each had sold a portion or all of such stock at losses, which, except as hereinafter noted, were deducted on their income tax returns (R. 16, 40, 63, Harwick, R. 10).

James N. Collins[3] sold 100 shares of this stock in 1930, which had cost $56,200, for $14,599.20 and thereby sustained a deductible loss of $41,600.80, which the taxpayer referred to in his 1930 Federal income tax return and the deductibility of which was not questioned by the Commissioner upon audit of the return.

Collins also sold 100 shares in 1931, which had cost $37,100, for $8,936.22 and sustained a loss of $28,163.78, which was referred to on his 1931 return and allowed by

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[3]Collins died on April 21, 1941, which was before his case was heard by the Board, and his executor was substituted as the petitioner, but for convenience Collins will be referred to here as the taxpayer (R. 15).

the Commissioner. Including these losses, the net loss disclosed in his income tax return for 1930 was $65,896.51, and for 1931, $40,204.90 (R. 16, 24). In addition to this stock Collins owned 100 shares of stock acquired at a cost of $30,000, which he continued to hold throughout the year 1939 (R. 16, 22).

Several years after the above sales Collins and the other taxpayers learned that grounds for rescinding these purchases existed. Accordingly, Collins filed suit against National City Company, as did each of the other taxpayers except Harwick, who merely asserted a claim against that company, each contending:

1. That the stock had been sold to them without having been registered, as required by state law, and

2. That the sales had been fraudulent.

The complaint in each suit embodied a request for a rescission of the sales contracts and also an offer to turn over the proceeds of the stock sales or an equal number of shares, plus income thereon (R. 16, 41, 64).

These suits, as well as Harwick's claim, were settled in 1939 by the company making payment to each of the taxpayers. Upon receipt of these payments the suits were dismissed with prejudice pursuant to a stipulation of the parties (R. 16, 41, 64). Harwick also executed an instrument releasing the National City Company from all claims which he had against it (Harwick, R. 11, 24).

As a result of this settlement James N. Collins received a net amount of $45,150.63, of which $23,296.45 was allocable to the stock sold in 1930 and $6,454.18 was allocable to the stock sold in 1931. The balance of the recovery was allocable to the stock which Collins still owned (R. 23). Collins did not report any of the recovery as income in 1939,

but the first two amounts allocable to the stock sold in 1930 and 1931, viz.: $29,750.63, were held by the Commissioner to be taxable income (R. 16-17).

Throughout the year 1939 adjustment of these taxpayers' income tax liability for 1930 and 1931 was barred by the Statute of Limitations (R. 17, 42, 65, Harwick, R. 13).

As to these recoveries in 1939, the Board held in effect that such payments constituted a return of capital and were not subject to tax unless the loss deductions of the prior years had actually offset gross income of those years and so had resulted in a tax benefit.

In applying this test the Board held as to James N. Collins that (1) since the amount received upon sale of the stock in 1930 and 1931, plus the amount recovered, was less than the original purchase price of the stock, viz.:

	1930		*1931*
Cost of stock	$56,200.00		$37,100.00
Sale price..$14,599.20		$8,936.22	
1939 Recovery 23,296.45		6,454.18	
Total Recovery	37,895.65		15,390.40
Net loss from transaction ...	$18,304.35		$21,709.60

(2) and since the losses referred to in the taxpayer's 1930 and 1931 tax returns did not offset any income, viz.:

	1930	*1931*
Net *losses* per return...	$65,896.51	$40,204.90
Eliminate entire loss on sale of National City Bank stock	41,600.80	28,163.78
Adjusted net *loss*.....	$24,295.71	$12,041.12

the taxpayer had not recovered or recouped his capital investment in this stock and therefore was not taxable on the sum recovered in 1939 allocable to the stock sold in 1930 and 1931 (R. 18-20).

From these decisions of the Board the Commissioner appealed in the cases involving the tax liability of E. W. Dobson, James N. Collins, and John V. Dobson. The taxpayer H. J. Harwick appealed and John V. Dobson took a cross-appeal from the portion of the decision of the Board dealing with the application of the principle referred to above to their particular facts, and from the portion of the decision of the Board holding that to the extent that taxable income resulted from the recoveries such income was taxable as ordinary income rather than as capital gain under Section 117 of the *Internal Revenue Code*. The cases were consolidated before the Circuit Court of Appeals for the Eighth Circuit and on March 2, 1943, that court entered the following decision (C. C. A., R. 14):

As to the appeals taken by the Commissioner, the court reversed the decision of the Board and held that the entire amounts recovered by the taxpayers in 1939 from National City Company constituted taxable income for the reason that according to the court (C. C. A., R. 10) the recoveries were "income when received" and, constituting income, could not be reduced by losses sustained in a year prior to 1939. The court therefore refused to pass on the first issue raised in the appeals by Harwick and John V. Dobson, and as to the second issue raised by them the court affirmed the decision of the Board and held that the entire amount recovered was taxable as ordinary income and not as capital gain.

REASONS FOR ALLOWANCE OF WRITS OF CERTIORARI

1. The Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income has decided that recoveries of capital may be taxed under the Federal income tax law and thus it has decided a question of Federal income tax law in a way which is in conflict with applicable decisions of this court.

2. The Circuit Court of Appeals in deciding that the sales of stock in years prior to 1939 were sufficient to sustain the conclusion that recoveries of the original purchase price in 1939 constituted income, even though the losses sustained as a result of the sales in such prior years did not offset or reduce taxable income for said years, has decided a question of Federal income tax law in a way which is in conflict with the decisions of other Circuit Courts of Appeal on the same matter.

3. If the decision of the Circuit Court of Appeals is not in conflict with the applicable decisions of this court (as alleged at 1 above), then the Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income has decided that recoveries of capital may be taxed under Federal income tax law and thus it has decided an important question of Federal income tax law which has not been, but should be, settled by this court.

4. The Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income which is taxable as ordinary income rather than as capital gain under Section 117 of the Internal Revenue Code has

decided an important question of Federal income tax law which has not been, but should be, settled by this court.

Wherefore, Your petitioners respectfully pray that writs of certiorari issue to the United States Circuit Court of Appeals for the Eighth Circuit and submit their brief hereto attached in support of this petition.

Respectfully submitted,

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BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

OPINIONS BELOW

The opinion of the Circuit Court of Appeals for the Eighth Circuit rendered March 2, 1943, ... Fed. (2d) ..., is found at C. C. A., R. 3. The opinions of the United States Board of Tax Appeals are found:

Estate of James N. Collins (R. 15),
E. W. Dobson (R. 40),
John V. Dobson (R. 62),
H. J. Harwick (Harwick, R. 10).

JURISDICTION

This petition is made under Sec. 240 of the *Judicial Code*, as amended, by the Act of February 13, 1925, 43 Stat. 938. The date of the judgments asked to be reviewed is March 2, 1943.

SUMMARY OF ARGUMENT

1. The Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income has decided that recoveries of capital may be taxed under the Federal income tax law and thus it has decided a question of Federal income tax law in a way which is in conflict with applicable decisions of this court.

2. The Circuit Court of Appeals in deciding that the sales of stock in years prior to 1939 were sufficient to sustain the conclusion that recoveries of the original purchase

price in 1939 constituted income, even though the losses sustained as a result of the sales in such prior years did not offset or reduce taxable income for said years, has decided a question of Federal income tax law in a way which is in conflict with the decisions of other Circuit Courts of Appeal on the same matter.

3. If the decision of the Circuit Court of Appeals is not in conflict with the applicable decisions of this court (as alleged at 1 above), then the Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income has decided that recoveries of capital may be taxed under Federal income tax law and thus it has decided an important question of Federal income tax law which has not been, but should be, settled by this court.

4. The Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income which is taxable as ordinary income rather than as capital gain under Sec. 117 of the *Internal Revenue Code* has decided an important question of Federal income tax law which has not been, but should be, settled by this court.

ARGUMENT

1. The Circuit Court of Appeals in Deciding That the Recoveries Realized by the Taxpayers in 1939 as the Result of a Rescission of Previous Stock Purchases Constitute Income Has Decided That Recoveries of Capital May Be Taxed Under the Federal Income Tax Law and Thus it Has Decided a Question of Federal Income Tax Law in a Way Which Is in Conflict With Applicable Decisions of This Court.

The Circuit Court of Appeals concluded (C. C. A., R. 10) that the recoveries from National City Company here involved were income when received. The court cited *no authority* for this proposition and the petitioners assert that it is contrary to the facts and law applicable to the recoveries.

The facts are clear. It has been stipulated (R. 22, 45, 76, Harwick, R. 21) that the taxpayers' claims arose out of the discovery in 1936, 1937, or 1938 of facts which led each of them to believe that the National City Bank of New York stock purchased by them had not been registered in accordance with the requirements of the Minnesota Blue Sky Laws and that said sales had been fraudulent. In addition to this stipulation the factual basis for the contention that the recoveries from National City Company did not constitute income is most clearly illustrated by the facts involved in the James N. Collins case. Collins acquired his stock in 1929 and sold it in 1930 and 1931 at a substantial loss. Had Collins not claimed *any* loss as a result of such sales in his 1930 and 1931 returns, such returns, nevertheless, would have disclosed losses of $24,295.80 and $12,041.12, respectively (R. 23, 24). Furthermore, the sum of the sales price of the stock in 1930 and 1931, plus the amounts recovered in 1939, was less than the original cost

of the stock to Collins (R. 16, 21-23). The importance of these facts with respect to the effect of the sales upon Collins' 1930 and 1931 tax liability is that they negative any conclusion that Collins is estopped to assert or can be said to have waived his right to claim that the recovery in 1939 constituted a capital recovery.

The applicable law as to the nature of the recovery is equally clear. The Minnesota Supreme Court has held upon numerous occasions that claims such as here involved are based upon a rescission of the contract of sale and a recovery of the purchase price.

Babcock vs. Bancamerica-Blair Corporation (1942), 212 Minn. 428, 4 N. W. (2d) 89;

Vercellini vs. U. S. I. Realty Co. (1924), 158 Minn. 72, 196 N. W. 672;

E. E. Webster vs. U. S. I. Realty Co. (1927), 170 Minn. 360, 212 N. W. 806;

Drees vs. Minnesota Petroleum Co. (1933), 189 Minn. 608, 250 N. W. 563;

Edson vs. O'Connell (1934), 190 Minn. 444, 252 N. W. 217;

See, also, *Vogel vs. Chase Securities Corporation* (1936), 19 Fed. Supp. 564.

The Board of Tax Appeals also characterized these recoveries as resulting from a rescission of the original sale (R. 17).

The Circuit Court of Appeals stated that the above facts and authorities were immaterial, and without citation of any authority or further explanation, other than the statement that the capital transaction was closed when the stock was sold, the court concluded that the recoveries were income when received. The Circuit Court of Appeals then proceeded to demonstrate, with ample citation of authority, that

losses and deficits for prior years could not be used to offset or reduce income for the current year. The petitioners submit that the basic and erroneous premise in the conclusion of the Circuit Court of Appeals is the proposition that these recoveries were income when received and that this premise has no support in the facts or the authorities. This premise upon which the decision of the Circuit Court of Appeals is based is contrary to decisions of this court in numerous cases.

In the case of *Bowers vs. Kerbaugh-Empire Co.* (1926), 271 U. S. 170, 46 Sup. Ct. 449, 70 L. Ed. 886, the taxpayer had borrowed money under a contract requiring repayment in German marks. After the declaration of war upon Germany the unpaid balance on this loan was paid off in German marks which at that time had greatly depreciated in value. As a result the difference between the United States dollars, into which proceeds of the original loan had been converted, and the United States dollars necessary to purchase the depreciated marks with which to pay off the loan was $684,456.18. The money when borrowed had been used in construction projects by the taxpayer and its subsidiary but these projects had resulted in substantial net losses prior to the year in which the debt was paid. The court, page 172, pointed out that the losses sustained in such prior years were in excess of the asserted income, viz.: $684,456.18, and stated that these were among the "essential facts" which supported the conclusion that this transaction did not result in income. The court further stated, page 174, that "In determining what constitutes income, substance rather than form is to be given controlling weight," and concluded, page 175, that "The mere diminution of loss is not gain, profit, or income."

The importance of the fact in the *Kerbaugh-Empire Co.* case, *supra,* that the transactions in prior years had result-

ed in net losses and the recognition of this court that whether or not such losses existed would determine the taxable character of subsequent capital transactions is demonstrated by later citations of that case by this court. *United States vs. Kirby Lumber Co.* (1931), 284 U. S. 1, 3, 52 Sup. Ct. 4, 76 L. Ed. 131; *Helvering vs. American Chicle Co.* (1934), 291 U. S. 426, 430, 54 Sup. Ct. 460, 78 L. Ed. 891.

The definition of income approved by the court in the *Kerbaugh-Empire Co.* case was based on previous decisions in which this court had held that a recovery of capital on an asset *held by the taxpayer at the time of the recovery* does not constitute income under the Sixteenth Amendment. See *Miles vs. Safe Deposit & Trust Co.* (1922), 259 U. S. 247, 42 Sup. Ct. 483, 66 L. Ed. 923; *Towne vs. Eisner* (1918), 245 U. S. 418, 38 Sup. Ct. 158, 62 L. Ed. 372; and *Eisner vs. Macomber* (1920), 252 U. S. 189, 206, *et seq.*, 40 Sup. Ct. 189, 64 L. Ed. 521, where this court said:

> "For the present purpose we recognize only a clear definition of the term 'income' as used in common speech in order to determine its meaning in the amendment * * *. Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit through a sale or conversion of capital assets * * *."

The definition of income quoted above also was approved by this court in *Goodrich vs. Edwards* (1920), 255 U. S. 527, 41 Sup. Ct. 390, 65 L. Ed. 758. That case involved Sec. 2 (c) of the *Revenue Act of 1916*, 39 Stat. 758, which provided that "For the purpose of ascertaining the gain derived from a sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, the fair market price or value of such property as of March 1, 1913, shall be the basis for determining the amount of such gain derived." The Commissioner had ruled that under this

statute the March 1, 1913, value was to be used in determining gain, even though that value was less than the cost to the taxpayer. The court rejected this contention, emphasizing that the *Revenue Act of 1916* (similar in this respect to the Revenue Acts here involved) imposed no tax except where *gains* were realized. Although the Solicitor General confessed error in the Goodrich case, the court later reaffirmed its conclusions and stated that its decision was not based on this confession of error. *United States vs. Flannery* (1925), 268 U. S. 98, 103, 45 Sup. Ct. 420, 69 L. Ed. 865.

In the case of *Burnet vs. Sanford & Brooks Co.* (1931), 282 U. S. 359, 51 Sup. Ct. 150, 75 L. Ed. 383, the taxpayer performed a contract for the United States Government which resulted in the realization of losses by the taxpayer while the contracts were being performed during the years 1913 to 1916. Subsequent to the abandonment of the work the taxpayer sued the United States and recovered additional compensation under the contract. This recovery was received by the taxpayer in 1920 and this court sustained the Commissioner in including the recovery in taxpayer's income for 1920, despite the fact that because of losses sustained on the Government work in 1913 to 1916, the taxpayer's income tax return had shown large net losses for all years except 1914. The basis for the decision was the conclusion that the recovery in 1920 constituted gross income for that year and that there was no statutory authority for disregarding the annual accounting periods so as to permit the bringing forward of losses sustained in prior years. It is apparent that the essential premise for the court's conclusion is the finding that the money which was received was an income as distinguished from a non-income item such as a return of capital or refund of previous expenditures. This court expressly recognized the prin-

ciple upon which we are here relying. The court said:

> "That the recovery made by respondent in 1920 was gross income for that year within the meaning of these sections cannot, we think, be doubted. The money received was derived from a contract entered into in the course of respondent's business operations for profit. While it equalled, and in a loose sense was a return of, expenditures made in performing the contract, still, as the Board of Tax Appeals found, the expenditures were made in defraying the expenses incurred in the prosecution of the work under the contract, for the purpose of earning profits. They were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income. See *Doyle vs. Mitchell Brothers Co., supra,* page 185 of 247 U. S., 38 Sup. Ct. 467."

In the case of *Koshland vs. Helvering* (1936), 298 U. S. 441, 56 Sup. Ct. 767, 80 L. Ed. 1268, the Commissioner contended that where common stock was received by a taxpayer as a dividend on preferred stock in the same corporation, the cost of said preferred stock for purposes of determining gain upon redemption thereof was not to be reduced by apportioning part of the cost to the common stock. The requirement of apportionment was embodied in regulations promulgated by the Commissioner. The court held that the rule laid down by the regulation was invalid and therefore the basis for the preferred stock was not reduced. The holding was based on this proposition:

> "Congress having clearly and specifically declared that in taxing income arising from capital gain the cost of the asset disposed of shall be the measure of the income, the Secretary of the Treasury is without power by regulatory amendment to add a provision that income derived from the capital asset shall be used to reduce cost."

The definition of income contained in the *Internal Revenue Code* is in accord with the above judicial principles. Sec.

22 (a), 53 Stat. 9, provides in part:

> "(a) General definition—'Gross income' includes *gains, profits,* and *income* derived . . . from . . . business . . . or sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from . . . the transaction of any business carried on for *gain* or *profit,* or *gains* or *profits* and *income* derived from any source whatever." (Italics added.)

See also Amendments to the Constitution of the United States, Art. XVI.

In considering the petitioners' contention that the above decisions of this court are in conflict with the conclusion of the Circuit Court of Appeals for the Eighth Circuit that the recoveries here involved constitute income, it should be noted that the petitioners concede that if the losses realized as a result of the sales of stock in prior years had been of tax benefit to them, they would be prevented under general equitable considerations from raising the contention that the recoveries here involved constitute a return of capital. There is ample authority for this concession.

Ilfeld Co. vs. Hernandez (1934), 292 U. S. 62, 54 Sup. Ct. 596, 78 L. Ed. 1127;

Griffiths vs. Commissioner (1939), 308 U. S. 355, 60 Sup. Ct. 277, 84 L. Ed. 319;

Helvering vs. Owens (1939), 305 U. S. 468, 59 Sup. Ct. 260, 83 L. Ed. 292;

Sec. 113 (b) (1) (A), *Internal Revenue Code,* 53 Stat. 44;

Sec. 19.113 (b) (1)-1, *Regulations 103;*

Secs. 23.33 and 23.34, *Regulations 104.*

2. The Circuit Court of Appeals in Deciding That the Sales of Stock in Years Prior to 1939 Were Sufficient to Sustain the Conclusion That Recoveries of the Original Purchase Price in 1939 Constituted Income, Even Though the Losses Sustained as a Result of the Sales in Such Prior Years Did Not Offset or Reduce Taxable Income For Said Years, Has Decided a Question of Federal Income Tax Law in a Way Which Is in Conflict With the Decisions of Other Circuit Courts of Appeal on the Same Matter.

The decision of the Circuit Court of Appeals for the Eighth Circuit in these cases is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in the case of *Pittsburgh Brewing Co. vs. Commissioner* (1939), 107 Fed. (2d) 155. In the latter case the taxpayer contended that in determining gain upon sale of property the basis or cost thereof should not be reduced by the amount of depreciation claimed in prior years' income tax returns in cases in which it was shown, and the Commissioner conceded, that (a) the amount of depreciation so claimed was excessive, and (b) the deduction to the extent of such excess was of no tax benefit to the taxpayer. The court sustained the taxpayer's contention and based its decision upon the proposition that the excess depreciation was not "allowed" within the meaning of the statute for the reason that the deduction had not offset or reduced income otherwise taxable.

While it is apparent that the specific section of the income tax law under consideration in the *Pittsburgh Brewing Company* case, viz.: the section of a prior Revenue Act corresponding to Sec. 113 (b) (1) of the *Internal Revenue Code*, 53 Stat. 44, is not involved in these cases, it is submitted that the general problem is the same. The Commis-

sioner in the *Pittsburgh Brewing Company* case was contending that excessive depreciation claimed in a tax return which was of no tax benefit was "allowed" within the meaning of a statutory provision requiring the reduction of basis by an amount equal to depreciation allowed or allowable. The Circuit Court of Appeals for the Third Circuit rejected this contention. In the cases here involved the Commissioner is contending and the Circuit Court of Appeals for the Eighth Circuit held that because the losses on the sale of stock were "sustained" under the provisions of Sec. 23 (e) (2) of the *Revenue Act of 1928*, 45 Stat. 791, "the capital transactions of the taxpayers were closed and their capital losses claimed and *allowed* in the years when the stocks were sold" (C. C. A., R. 10). (Italics added.)

The fundamental conflict between the Circuit Court of Appeals for the Third Circuit and the decision of the Circuit Court of Appeals for the Eighth Circuit is demonstrated by the recent decision of the Circuit Court of Appeals for the Fourth Circuit in the case of *Helvering vs. Virginian Hotel Corporation* (1943), 132 Fed. (2d) 909. The court in this case rejected the decision of the court in *Pittsburgh Brewing Company vs. Commissioner, supra,* and in so doing relied on the previous decision of the Circuit Court of Appeals for the Fourth Circuit in the case of *Helvering vs. State-Planters Bank & Trust Co.* (1942), 130 Fed. (2d) 44. The latter decision involved the question whether the recovery with respect to a bad debt previously charged off constituted taxable income where the deduction for the bad debt charged off had been of no tax benefit. The court held that such a recovery constituted taxable income and this decision was relied on by the Circuit Court of Appeals for the Eighth Circuit in support of its decision in the cases now presented to this court. The identity in principle involved in the bad debt case decided by the Fourth Circuit and the

depreciation cases decided by the Third and Fourth Circuits is further demonstrated by the provisions of Sec. 19.23 (k)-1 of *Regulations 103* (as they existed prior to amendment on March 1, 1943, pursuant to Sec. 116 of the *Revenue Act of 1942*, Public Law 753), and similar provisions of previous regulations. This section of the regulations provides in part:

> "Any amount subsequently received on account of a bad debt or on account of a part of such debt previously charged off and *allowed* as a deduction for income tax purposes must be included in gross income for the taxable year in which received." (Italics added.)

It will be observed that the problem of construction presented by the regulations with respect to deduction for bad debts "allowed" is identical to the problem of construction presented by the statute with respect to excessive depreciation "allowed."

The petitioners, therefore, assert that the above two decisions of the Circuit Court of Appeals for the Fourth Circuit and the decision of the Circuit Court of Appeals for the Eighth Circuit here involved all are based on a common principle and all are in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in the case of *Pittsburgh Brewing Company vs. Commissioner, supra.* This court granted certiorari in *Virginian Hotel Corporation of Lynchburg vs. Commissioner, supra,* No. 766, on April 5, 1943.

The petitioners believe that it is incumbent upon them to call the court's attention to the case of *Commissioner vs. United States & International Securities Corporation* (1942, C. C. A. 3), 130 Fed. (2d) 894. This case involved the same problem presented in the case of *Helvering vs. State-Planters Bank & Trust Co., supra,* and the court reached the same conclusion. It appears to the petitioners that the Cir-

cuit Court of Appeals for the Third Circuit has reached inconsistent conclusions in the *Pittsburgh Brewing Co.* case, *supra*, and the *United States & International Securities Corporation* case, *supra*.

3. If the Decision of the Circuit Court of Appeals Is Not in Conflict With the Applicable Decisions of This Court (as Alleged at 1 above), Then the Circuit Court of Appeals in Deciding That the Recoveries Realized by the Taxpayers in 1939 as the Result of a Rescission of Previout Stock Purchases Constitute Income Has Decided That Recoveries of Capital May Be Taxed Under Federal Income Tax Law and Thus it Has Decided an Important Question of Federal Income Tax Law Which Has Not Been, But Should Be, Settled by This Court.

Petitioners, as an alternative ground for granting this writ of certiorari, submit that the question here involved is important and if the Supreme Court decisions cited at 1 above are not controlling the question presented by this case should be finally settled by this court. The petitioners believe that the question here involved is fundamental in the administration of our income tax law. If the definition of income is subject to absolute control by the Commissioner or the Congress and if there are to be no standards as to what is capital, other than the bare statement of the court unsupported by authority, we believe that the contrary inferences which have been drawn from decisions by this court should be clearly rejected. The Circuit Court of Appeals for the Eighth Circuit has admitted that the recovery here involved constituted a recovery of the purchase price which beyond question was an expenditure of capital. Nevertheless, that court concluded that these recoveries of capital constituted income. The importance of such a determina-

tion to the administration of the income tax law is self-evident.

The number of cases bearing upon this type of problem is constantly growing. See cases cited under 2 above. Although we are unable to furnish the court with any statement as to the number of cases involving the exact point presented by these cases, we can assure the court that there was extensive litigation in Minnesota involving similar actions for rescission and resulting in very substantial settlements in 1939 and 1940. The number of these cases in Minnesota was approximately 1,010. Again, we have no way of ascertaining the number of cases presenting the "tax benefit" problem involved in these cases, but we believe that a very substantial proportion of the total number of cases does involve this point. This fact, plus the general litigation involving "tax benefit" theories, is sufficient to justify the granting of writs of certiorari.

4. The Circuit Court of Appeals in Deciding That the Recoveries Realized by the Taxpayers in 1939 as the Result of a Rescission of Previous Stock Purchases Constitute Income Which Is Taxable as Ordinary Income Rather Than as Capital Gain Under Sec. 117 of the Internal Revenue Code Has Decided an Important Question of Federal Income Tax Law Which Has Not Been, But Should Be, Settled by This Court.

Petitioners believe that certiorari also should be granted with respect to the question as to whether the recoveries to the extent found to be taxable constitute capital gain under Sec. 117 of the *Internal Revenue Code*, 53 Stat. 50, rather than ordinary income. Both the Board and the Circuit Court of Appeals for the Eighth Circuit rejected this contention in these cases, but there are no other decisions passing

on this question. As noted above, approximately 1,010 taxpayers in Minnesota alone realized recoveries similar to those here involved, and petitioners believe that most of these taxpayers have this issue involved. Of these cases approximately 500 resulted in the assertion of deficiency taxes by the Commissioner of Internal Revenue. Petitioners, therefore, believe that this question is important and has not been, but should be, settled by this court.

The following is a brief statement of petitioners' contentions:

Section 117 of the *Internal Revenue Code* provides that when income is properly classified as long-term capital gain only fifty per cent thereof is to be taxed, instead of taxing the entire gain as in the case of other income. Subdivision A-5 of Section 117 defines long-term capital gain as follows:

> "The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 18 months, after and to the extent such gain is taken into account in computing net income."

It is not disputed that, to the extent the petitioners realized taxable income from the recoveries here involved, such income was realized upon disposition of a capital asset and we believe that the Commissioner will concede that the capital asset was held more than 18 months. The sole question to be decided, therefore, is whether the capital asset, upon which the gain was realized, was disposed of by the taxpayer in a "sale or exchange." It is the petitioners' contention that whatever taxable income was realized as the result of a recovery from National City Company in 1939 was realized from a "sale or exchange" and therefore is taxable as capital gain. The determination of this issue requires an inquiry into the nature of the transaction which resulted in the recovery. As previously pointed out in this brief, the petitioners' claims against National City Company were based on the right to rescind the purchases and

secure a refund of the purchase price. It also is admitted by the Commissioner that where a taxpayer continued to hold his National City Bank of New York stock, the recovery in 1939 attributable to such stock was not taxable. It follows, therefore, that the receipt of income in 1939 (to whatever extent taxable) represented "gain from the sale" of the stock *in 1931* which was not taxable until 1939, at which time it was received by a cash basis taxpayer. The quoted phrase is from Section 117 of the *Internal Revenue Code,* and it is submitted that it accurately describes the source of whatever gain may be deemed taxable in this case. It seems clear that even under the Commissioner's theory the taxable income was not "from" the recovery in 1939 because, unless there was a prior sale of the stock, there is no taxable income as the result of that recovery. The gain then must be "from" the sale of the stock in 1931. Although the Commissioner and the taxpayer may differ as to whether the 1931 sale caused part or all of such "gain" realized in 1939 to be taxable merely because the loss was claimed in 1931 or because the loss was of tax benefit in that year, we seem to be agreed that it was the 1931 sale which gives part or all of this 1939 recovery its character as taxable income. The mere fact that the gain was received and taxed in a year long after 1931 should not prevent it from taking its character as capital gain from the events in 1931. A common example of a similar situation is found in the taxation of gain on installment sales under Section 44 of the *Internal Revenue Code,* 53 Stat. 24. Gains under this section are taxed in proportion to the amount received in years subsequent to the year of sale and such gains are classified as capital or ordinary gain pursuant to the law applicable to the year in which the gain is received. *Snell vs. Commissioner* (1938, C. C. A. 5), 97 Fed. (2d) 891.

CONCLUSION

For the reasons stated your petitioners respectfully pray that writs of certiorari issue to enable this court to review the judgment of the Circuit Court of Appeals in these cases.

Dated April 6, 1943.

Respectfully submitted,

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